

June 6, 2012

To: Members,  
Executive Committee

Re: Executive Committee: Proposed Commercial Terms to Supply Treated Waste Water to Western Potash Corp.

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**RECOMMENDATION OF THE EXECUTIVE COMMITTEE  
- MAY 23, 2012**

1. That the key commercial terms for the supply of recycled water from the Waste Water Treatment Plant (WWTP) to Western Potash Corp. (WPC) as outlined in Appendix A to this report be approved in principle.
2. That the City of Regina (City) act as the proponent for the water supply arrangements and apply for the necessary environmental/regulatory approvals.
3. That the Deputy City Manager of City Operations be authorized to resolve the final terms and conditions of definitive agreements with WPC based on the key commercial terms as outlined in the report, including the following:
  - (a) Water Access Agreement;
  - (b) Maintenance and Operating Services Agreement;
  - (c) Lease Agreement; and,
  - (d) Easement Agreement.
4. That the City Clerk be authorized to execute the agreements after review by the City Solicitor.
5. That the Administration returns to Council by July 2012 with a report outlining options on allocation of revenues associated with this agreement.

*EXECUTIVE COMMITTEE – MAY 23, 2012*

The Committee adopted a resolution to concur in the recommendation contained in the report.

Mayor Pat Fiacco, Councillors: Louis Browne, Sharron Bryce, Fred Clipsham, John Findura, Michael Fougere, Terry Hincks, Jocelyn Hutchinson, Wade Murray, Mike O'Donnell and Chris Szarka were present during consideration of this report by the Executive Committee.

The Executive Committee, at the **PRIVATE** session of its meeting held on May 23, 2012, considered the following report from the Administration:

## RECOMMENDATION

1. That the key commercial terms for the supply of recycled water from the Waste Water Treatment Plant (WWTP) to Western Potash Corp. (WPC) as outlined in Appendix A to this report be approved in principle.
2. That the City of Regina (City) act as the proponent for the water supply arrangements and apply for the necessary environmental/regulatory approvals.
3. That the Deputy City Manager of City Operations be authorized to resolve the final terms and conditions of definitive agreements with WPC based on the key commercial terms as outlined in the report, including the following:
  - a. Water Access Agreement;
  - b. Maintenance and Operating Services Agreement;
  - c. Lease Agreement; and,
  - d. Easement Agreement.
4. That the City Clerk be authorized to execute the agreements after review by the City Solicitor.
5. That the Administration returns to Council by July 2012 with a report outlining options on allocation of revenues associated with this agreement.

## CONCLUSION

Negotiations between Administration and WPC have been successful in producing a mutually agreeable set of commercial terms for consideration by City Council and WPC's Board of Directors. The proposed commercial terms will provide benefits to both the City and WPC, and fulfill the following objectives:

- The generation of a new, long term revenue source for the City;
- Revenue maximization and the deliverance of competitive value to citizens;
- Support of regional industrial growth and economic development;
- Positive environmental project consistent with a sustainable community;
- Stable and reliable partnership with a positive working relationship;
- Publicly defensible terms and conditions; and,
- Effective risk mitigation.

## BACKGROUND

On July 4, 2011 City Council approved the Administration entering into negotiations with WPC regarding the supply of water to WPC's proposed solution potash mine near Gray, SK, approximately 35 km southeast of Regina.

The negotiations originally considered the supply of potable and recycled water and the provision of the associated infrastructure from the WWTP to the mine site. However, WPC revised its original request for services as discussions progressed. WPC no longer required a potable water source from Regina, and was primarily interested in the supply of recycled water and the operation and maintenance (O & M) of water supply infrastructure that would be owned solely by WPC.

To date, the City has not been involved in commercial arrangements to supply treated waste water for industrial, agricultural or other purposes. As a result, the City does not have a rate structure or pricing methodology in place to charge potential users of recycled water. Therefore, the City engaged an external consultant, MNP LLP to conduct market research and collect comparative pricing information for recycled water from utilities across North America. Additionally, MNP LLP provided the Administration with information on the structure of water supply agreements, and to the degree possible, an analysis of the local market for industrial water supply. That information was used as the basis for the City's negotiating position with WPC.

## DISCUSSION

The Administration established a number of objectives that were key considerations throughout the negotiations with WPC. Those objectives, in no particular priority, include:

- The generation of a new, long term revenue source for the City;
- Revenue maximization and the deliverance of competitive value to citizens;
- Support of regional industrial growth and economic development;
- Positive environmental project consistent with a sustainable community;
- Stable and reliable partnership with a positive working relationship;
- Publicly defensible terms and conditions; and,
- Effective risk mitigation.

The City and WPC have reached mutual agreement on the recommended key commercial terms (Appendix A) that includes, but is not limited to:

1. The City will provide access to recycled water to WPC for a term of 45 years.
2. The City will provide WPC with access for up to 60,000 cubic meters of recycled water per day for the first six years of mine operation (flow expected to begin 2016) and up to 42,240 cubic meters per day for the remaining 39 years of the contract.
3. A connection fee will be payable by WPC to the City for the access to the supply of recycled water. WPC will pay the City to have access to a maximum water supply volume (as outlined in 2.) and will pay the City whether it uses that entire allocation or not. WPC will be required to pay the City at WPC's option, based on the following:
  - a. An annual connection fee of \$0.25 per cubic metre inflated by 1% per year beginning in 2015 for up to 21.9 M cubic meters of water (estimated average annual revenue in years 1-6 is \$5.6 Million and \$5 Million for each year thereafter); or,
  - b. An \$80 Million up front, non-refundable connection fee in 2012; or,
  - c. An upfront, non-refundable connection fee based on the following schedule after 2012:

Year	Single payment	Split payment over 2 years
2013	\$85.5 Million	
2014	\$90 Million	\$45 Million in 2014 and \$47.3 Million in 2015
2015	\$94.5 Million	\$47.3 Million in 2015 and \$49.6 Million in 2016
2016	\$99.3 Million	\$49.6 Million in 2016 and \$52.1 Million in 2017
2017	\$104.2 Million	\$52.1 Million in 2017 and \$54.7 Million in 2018
2018	\$109.4 Million	\$54.7 Million in 2017 and \$57.4 Million in 2019
2019	\$114.8 Million	

\*The amounts in years 2014-2019 have been adjusted to be equivalent to the one time payment of \$80 Million in 2012.

4. WPC will pay the City a commitment fee of \$500,000 upon execution of the final agreement. If WPC begins to flow water on or before December 31, 2016, the commitment fee will be credited against WPC's annual/upfront connection fee. If WPC does not flow water by December 31, 2016, the City keeps the commitment fee. WPC will be required to pay the City a stand-by fee of \$200,000 per year after 2016 for each year that water doesn't flow, up to and including 2019.
5. The agreement will terminate if water does not flow by 2019 and the City will keep any commitment, connection and stand-by fees previously paid.
6. WPC will own the water supply infrastructure, and be responsible for all capital costs associated with that infrastructure and any modification to existing City owned infrastructure that is necessary.
7. The City and WPC will enter into an operating and maintenance agreement wherein the City will provide WPC with operating and maintenance services on a cost plus basis. WPC will pay the City all direct costs including but not limited to; labour, overtime, insurance, supplies, equipment, consultants, and contactors. WPC also agrees to pay the City 17% overhead on the annual maintenance costs and a 15% annual mark-up not exceeding \$200,000.
8. WPC will pay the City of Regina \$2,000 per acre/year to lease City owned land for a pump house at the WWTP. The cost to lease the land will increase by 10% every 5 years.
9. WPC will pay the city \$7,200/acre (estimated 8 acres) for a permanent easement for the portion of the pipeline right-of-way that is located on City owned lands.
10. The City of Regina will act as the proponent for environmental approvals relating to the water supply arrangements, and will make a reasonable effort to acquire the necessary environmental and regulatory approvals. WPC will be responsible to cover the costs for any mitigations or improvements deemed necessary by regulators through the environmental approval process.

Administration is confident that the proposed commercial terms meet the objectives set out, and as described in the following sections.

### **The Generation of New, Long Term Revenue Source to the City**

The terms as proposed would provide the City with an additional revenue source over the 45 year term of the contract. The expected cash flow over the term of the proposed agreement, based on yearly connection fee payments, is \$228 Million. The Net Present Value of the proposed agreement (which compares the value of a dollar in the future, to the value of a dollar today), is approximately \$80 Million.

### **Revenue Maximization and Deliverance of Competitive Value to Citizens**

Administration hired MNP LLP to do a market assessment of North American utilities to understand the rates charged for recycled water. The report highlighted that the amounts charged by utilities varies significantly (from \$0.08 to \$2.28 per cubic metre). There is no standard

pricing system or methodology for recycled water, and utilities will consider different factors when setting their prices. As a result, direct comparisons are difficult to make since utilities have different arrangements with respect to: mandates for the use of recycled water; ownership of the capital infrastructure; responsibilities for operation and maintenance; and, the level of processing that is necessary. MNP LLP's review confirmed that treated effluent is a valuable commodity in the market and provided analysis and information for the City to consider in the negotiations.

Ultimately, it is through good faith negotiations that a fair price will be reached that meets the objectives of both parties. Administration is confident that the negotiation process has led to an agreement that offers competitive value to the citizens of Regina.

### **Support for Regional Industrial Growth and Economic Development**

WPC's proposed potash mine is 35 km southeast of Regina. The proximity of the mine to Regina will provide economic benefits to the businesses and citizens of Regina. The capital expenditures required to get the mine operational is estimated by WPC at \$2.4 Billion and the annual cost for labour is estimated at approximately \$30 to \$37 Million. The mine development will undoubtedly generate economic spin-off that would positively impact Regina and the regional economy.

### **Positive Environmental Project Consistent with a Sustainable Community**

The supply of recycled water to WPC's mine, for normal operations, would reduce the volume of treated effluent being discharged into Wascana Creek by about 40%. The current discharge from the WWTP flow is 70,000 cubic metres. The diversion of effluent from the Creek is anticipated to have both positive and negative environmental impacts. On the one hand, the diversion would improve the quality of the water in the creek and downstream lakes. On the other hand, removing flow from the creek could affect the habitat. These impacts will be assessed, approved and mitigated if necessary, through a formal environmental review process required by provincial and federal regulators.

The environmental review process will consist of a project description and preliminary environmental assessment, which must be submitted to provincial and federal regulators for review and approval. Provincial and federal regulators will determine the need for a full Environmental Impact Assessment after they have reviewed the project description and preliminary environmental assessment.

The City expects that the improved water quality, as a result of less discharge of effluent or some type of fish habitat compensation, may mitigate any negative effects from the project. The City and WPC have agreed that if any additional mitigation is required, it would be the responsibility and expense of WPC.

To enable the City to supply recycled water to WPC and other future customers, the City is required to submit a project description being submitted to the Province which provides an assessment of the impacts of diverting 100% of the treated effluent from Wascana Creek. Baseline environmental work has already been carried out by CanNorth Environmental Services (CanNorth) on behalf of WPC. The City will be working with WPC and CanNorth to continue the necessary work to ensure that the environmental review process is completed. This process will require and involve consultation with all affected parties.

## **Stable and Reliable Partnership with a Positive Working Relationship**

The agreement with WPC is a long term arrangement that provides benefits to both WPC and the City. The two parties will continue to work collaboratively through ongoing planning, coordination and information exchange. The agreement formalizes the City's participation in a Joint Development Committee and the City will work with WPC in establishing annual operating and maintenance agreement and services.

## **Publicly Defensible Terms and Conditions**

The Administration is confident that the draft commercial terms will provide value to the citizens of Regina and that the City has protected itself from unwarranted future liabilities. Through good faith negotiations, the City and WPC have been able to arrive at mutually acceptable terms.

## **Effective Risk Mitigation**

A key consideration for the City in reaching an agreement is minimal exposure to risk, and where risk exists, appropriate strategies to mitigate that risk. One area that offered a high degree of potential risk to the City is ensuring that WPC has access to the volume of recycled water needed to operate the mine (60,000 cubic meters per day for the first six years and 42,240 for the remaining 39 years). The City has done a historical analysis of the volume of treated effluent discharged by the WWTP, and discovered that there have been some days when water volumes have been below WPC's requirements. The commercial terms specify that the City will not guarantee water volumes to WPC. The City remains confident that there will be sufficient volume over the 45 year term and that WPC can create viable engineering and construction solutions to regulate the daily water flow to meet their requirements.

Changes in global markets can influence the level of potash production, as witnessed in 2009. If similar factors, such that happened in 2009, occur in the future it could potentially impact WPC's production levels, which affects the amount of water they need and the revenue generated by the City. However, the draft commercial terms are not based on WPC's actual water use, but instead, on a minimum annual or upfront connection fee. WPC will be required to pay the City the full amount, whether they use the entire water allocation or not. Therefore, the City's annual revenue is not dependant on WPC's production levels.

The length of the proposed agreement and locking into a fixed price is also a potential risk to the City. While Administration is recommending that Council approve commercial terms that include a connection fee of \$0.25 inflated by 1% per year (or, alternatively, an equivalent upfront lump sum payment), there is the possibility that the value of recycled water could substantially increase over the term of the agreement and become a missed revenue opportunity.

There is also a risk that WPC will be unable to secure the investment it needs to proceed with mine development, or that other factors could stall the mine development beyond 2019 when the draft commercial terms become null and void. In that event, the COR may miss the opportunity to sell treated effluent to another customer. The City has attempted to mitigate some of that risk within the draft commercial terms by requiring WPC to provide the City with commitment and standby fees to hold the commercial terms until 2019. The City would receive at least \$1.1 Million dollars in the event the project does not proceed by 2019. The City will also keep the commitment fee if WPC elects to pay the City on an annual, lump sum basis.

The City Solicitor's Office is currently working with WPC's legal counsel to negotiate and finalize the necessary legal documents based on the draft commercial terms, with a goal of minimizing the City's risk exposure as much as possible. Overall, from a risk perspective, the Administration is satisfied that the draft commercial terms place minimal risk on the City.

### **Waste Water Regulations and Upgraded WWTP**

The provincial government will require the City to meet new effluent limits in 2016. The diversion of treated effluent from Wascana creek to WPC's proposed potash mine will have no affect on the City's responsibility to upgrade the WWTP to meet these new limits. The provincial regulations require that any treated effluent discharged into Wascana creek (whether it is 1 litre or 1 mega litre) meets the prescribed limits. While a substantial volume of effluent will be diverted from the creek as a result of this project, it won't alter the City's responsibility to ensure it has full capacity to treat and release any volume of effluent discharged into the creek.

### **Revenue Considerations**

Should Council approve the key commercial terms, it will provide the City with an alternative and new revenue stream. City Council will need to consider where to direct any new revenue which this initiative would provide. The Administration will bring forward analysis and recommendations to Council on how the revenue may be allocated. Important considerations will depend on if, when and how the City receives those revenues (i.e. if the mine proceeds, and then, if whether payments are upfront or annualized).

### **RECOMMENDATION IMPLICATIONS**

#### **Financial Implications**

The terms, as proposed, would provide the citizens of Regina with additional revenue of an estimated \$85 Million on a NPV basis over the 45 year term (which includes water revenue, O&M and leasing costs), if the mine proceeds. It should be recognized that this potash mine project is in the development stage, and requires substantial additional investment before it can proceed. If, for whatever reason, the WPC mine does not become fully operational, the City however, could still receive up to \$1.1 Million (or \$859,436 NPV) in commitment and standby fees. The Administration will bring forward analysis and recommendations to Council on how any revenues received, may be allocated.

#### **Environmental Implications**

To enable this initiative and the supply of recycled water to other future customers, the City is required to submit a project description and preliminary environmental assessment to provincial and federal regulators. Provincial and federal regulators will assess the impacts and determine if any mitigating measures will be required, through an established formal environmental review process. Provincial and federal approval of the project, will be contingent upon any mitigating measures deemed necessary, being fully addressed. The proposed commercial terms require all necessary environmental approvals be obtained before the project can proceed, and that WPC is responsible for all expenses related to the environmental process and any mitigating measures deemed necessary by provincial and federal regulators.

### Strategic Implications

This initiative supports City Council's vision of Regina being Canada's most vibrant, inclusive, attractive, sustainable community where people live in harmony and thrive in opportunity.

This initiative supports the City's strategic priorities to optimize resources through innovation, and to close the infrastructure funding gap.

### Other Implications

None with respect to this report.

### Accessibility Implications

None with respect to this report.

### COMMUNICATIONS

The Administration will develop a communications strategy based on Council's decision. If Council approves the recommendations and key commercial terms, there may be an opportunity to have a formal media announcement including key officials with WPC.

### DELEGATED AUTHORITY

The recommendations of this report require City Council approval.

Respectfully submitted,

EXECUTIVE COMMITTEE



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Joni Swidnicki, Secretary